

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 SSO-00 INRE-00 NSCE-00

USIE-00 SP-02 AID-05 EB-08 SS-15 STR-05 OMB-01

CEA-01 CIAE-00 COME-00 FRB-03 INR-07 NSAE-00

XMB-02 OPIC-03 LAB-04 SIL-01 DODE-00 /070 W

-----110174 231622Z /47

O R 231400Z SEP 77

FM AMEMBASSY ROME

TO SECSTATE WASHDC IMMEDIATE 7371

TREASURY DEPT WASH DC IMMEDIATE

INFO AMEMBASSY BRUSSELS

AMEMBASSY PARIS

USDOCOSOUTH NAPLES

AMCONSUL FLORENCE POUCH

AMCONSUL GENOA POUCH

AMCONSUL MILAN POUCH

AMCONSUL NAPLES POUCH

AMCONSUL PALERMO POUCH

AMCONSUL TRIESTE POUCH

AMCONSUL TURIN POUCH

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STATE PASS FRB; USEEC; USOECD; USDOCOSOUTH FOR INTAF

E.O. 11652: N/A

TAGS: EFIN, IT

SUBJ: ITALIAN PERFORMANCE AGAINST IMF AND EC TARGETS  
AND GUIDELINES (THIRD REPORT)

REF: A. ROME A-251, B. ROME 11853, C. ROME 13014

1. SUMMARY. THERE IS NOT MUCH NEW DATA SINCE EMBASSY'S  
LAST REPORT ON ITALIAN PERFORMANCE (REF C),BUT WHAT NEW  
DATA THERE IS INDICATES ITALY STILL ON TRACK AND SHOULD MEET  
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OR BE VERY CLOSE TO TARGETS AND GUIDELINES. INFLATION  
CONTINUES TO SLOW, AND INDICATORS SUGGEST THAT CURRENT  
ACCOUNT OF BALANCE OF PAYMENTS MIGHT END YEAR IN BALANCE.  
UNHAPPINESS, HOWEVER, CONTINUES TO BE EXPRESSED BY SOME  
OBSERVERS WHO CLAIM LOW DOMESTIC CREDIT CEILING IS CAUSING  
PRODUCTION TO FALL TOO RAPIDLY AND SLOWING GROWTH TOO MUCH,  
AND WHO FEEL THE 1978 CEILINGS ARE PARTICULARLY FOREBODING.

GOVERNMENT WILL GIVE ITS FORECASTS FOR 1977 AND 1978 IN ITS FORECAST AND PLANNING REPORT TO BE APPROVED BY COUNCIL OF MINISTERS IN SEPTEMBER 28. END SUMMARY.

2. DOMESTIC CREDIT EXPANSION. DATA THROUGH THE SECOND QUARTER SHOW THAT THE IMF TARGET WAS MET, AS WAS THE EC TARGET FOR THE SECOND QUARTER. CUMULATIVE DATA FOR THE FIRST SIX MONTHS, HOWEVER, EXCEED THE EC CUMULATIVE TARGET. AS POINTED OUT PREVIOUSLY, HOWEVER, THE FIRST QUARTER TARGET SET WITH THE EC IS NOT VERY MEANINGFUL, SINCE THE QUARTER WAS ALREADY COMPLETED WHEN THE AGREEMENT WAS REACHED. NEVERTHELESS, THE FIRST QUARTER EXCESS OF 1,300 BILLION LIRE WILL CARRY THROUGH TO THE END OF THE CALENDAR YEAR AND CONTINUE TO BLOAT THE CUMULATIVE DATA. CONCERN IS BEGINNING TO MOUNT EVEN IN SOME OFFICIAL QUARTERS THAT THE 30,000 BILLION LIRE TARGET FOR CY 1978 IS TOO DEFLATIONARY AND NEEDS TO BE REVISED.

TABLE 1  
DOMESTIC CREDIT EXPANSION  
(BILLIONS OF LIRE)

	I	II	CY 77	IMF YEAR	CY 78
EC TARGET	6,100	8,200	30,600		30,000
CUMUL.		14,300			
IMF TARGET		8,200	30,000	30,000	
ACTUAL	7,421	8,236			

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CUMUL. 15,657

3. PUBLIC SECTOR CASH-BEFICIT. NO NEW DATA IS AVAILABLE ON THE PUBLIC SECTOR CASH OPERATION BEYOND SIX MONTHS REPORTED REF C, IN WHICH THE NET TREASURY DEFICIT WAS WITHIN THE TARGET. AS TO THE ENLARGED DEFICIT, A LAW PASSED BY PARILAMENT ON JULY 8 REQUIRES THE MINISTRY OF TREASRUY TO SUBMIT BEGINNING JANUARY 31, 1978 (AND QUARTERLY THEREAFTER), CASH BUDGET FORECASTS FOR THE ENTIRE PUBLIC SECTOR. THIS WILL EXTND THE QUARTERLY CASH FORECAST REQUIREMENT TO THE AUTONOMOUS AGENCIES (RAILWAYS, POST AND TELEGRAPH, HIGHWAYS, STATE TELEPHONE AND MONOPOLIES), HOSPITALS, MUNICIPAL ENTERPRISES, PORT AUTHORITIES AND THE NATIONAL ELECTRICAL ENERGY AGENCY (ENEL). BEFORE THAT DATE, NO INFORMATION ON CASH EXPENDITURES OF THIS GROUP ARE LIKELY TO BE AVAILABLE. IN ACCORDANCE WITH THE LETTER OF INTENT, THE COMBINED DEFICITS IN 1977 OF THE HEALTH (INCLUDING HOSPITALS), SOCIAL SECURITY AND ELECTRICAL ENERGY AGENCIES THIS YEAR MUST BE HELD TO 3,350 BILLION LIRE, BUT NO DATA IS CURRENTLY AVAILABLE TO MEASURE COMPLIANCE AGAINST THIS GUIDELINE. THEE HAVE BEEN SOME RUMORS THAT THE ENEL DEFICIT MAY BE QUITE HIGH IN 1977,

AND OTHER SUGGESTIONS THAT A DROP OF 2,000 BILLION LIRE  
IN 1978 (FROM 16,450 TO 14,450 BILLION LIRE) IN THE  
ENLARGED DEFICIT IS UNREALISTIC. THE FOLLOWING TABLE RECAP-  
ITULATES ACTUAL DATA AND THE TARGETS THROUGH 1978.

TABLE 2  
PUBLIC SECTOR CASH DEFICIT  
(BILLIONS OF LIRE)

	IMF/EC GOI EST.	IMF/EC	
ACTUAL:	1ST HALF	CY 77	CY 78
BUDGET DEFICIT	-5,871	-9,900	-9,570
OTHER TREAS. OPS.	-2,457	-3,500	-3,930
TOTAL DEFICIT	-8,328	-13,400	-13,500
LESS: SPECIAL			
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CR. INST. LOANS	132	300	400
NET TREASURY			
DEFICIT	-8,196	-13,100	-13,100
TARGETS:			
NET TREAS. DEFICIT	-8,700	-13,100	
DEFICITS OF INS.,		-3,350	
ENLARGED DEFICIT		-16,450	-14,450

4. CENTRAL BANK FINANCING OF TREASURY DEFICIT.  
THE LATEST DATA SHOW THAT THE TREASURY'S LIABILITIES TO THE  
BANK OF ITALY HAVE BEEN REDUCED BY 4,223 BILLION LIRE.  
IN JUNE ALONE, THESE WERE REDUCED BY 2,055 BILLION LIRE.  
SINCE THE EC GUIDELINE PROVIDES FOR AN INCREASE OF 4,000  
BILLION LIRE IN TOTAL TREASURY BORROWING FROM THE BANK OF  
ITALY IN 1977, TREASURY'S  
MARGIN FOR BORROWING FROM THE BANK OF ITALY IS NOW 8,000  
BILLION LIRE. AS POSITIVE AS THIS SITUATION LOOKS AT  
PRESENT, IT IS TO BE BORNE IN MIND THAT THE SECURITIES  
MARKET IS HIGHLY VOLATILE AND SUBJECT TO WIDE SWINGS.  
NEVERTHELESS, IT SEEMS LIKELY THAT THE GUIDELINES AGREED  
TO WITH THE EC WILL BE MET.

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ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 SSO-00 INRE-00 NSCE-00  
 USIE-00 SP-02 AID-05 EB-08 SS-15 STR-05 OMB-01  
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O R 231400Z SEP 77  
 FM AMEMBASSY ROME  
 TO SECSTATE WASHDC IMMEDIATE 7372  
 TREASURY DEPT WASH DC IMMEDIATE  
 INFO AMEMBASSY BRUSSELS  
 AMEMBASSY PARIS  
 USDOCOSOUTH NAPLES  
 AMCONSUL FLORENCE POUCH  
 AMCONSUL GENOA POUCH  
 AMCONSUL MILAN POUCH  
 AMCONSUL NAPLES POUCH  
 AMCONSUL PALERMO POUCH  
 AMCONSUL TRIESTE POUCH  
 AMCONSUL TURIN POUCH

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TABLE 3  
 CENTRAL BANK FINANCING OF TREASURY DEFICIT  
 (BILLIONS OF LIRE)  
 CUMMUL.  

	I	II	1ST HALF	CY
EC GUIDELINE				4,000
EMBASSY BENCHMARK				
ESTIMATE				2,650
ACTUAL	-520	-3,703		-4,223

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5. CENTRAL GOVERNMENT CASH EXPENDITURES. AS REPORTED  
 REF C, DATA FOR FIRST HALF SUGGEST THAT EXPENDITURES WERE  
 ON TRACK. DATA SINCE AVAILABLE FOR THE MONTH OF JULY  
 APPEAR SLIGHTLY HIGH BUT, SINCE AUGUST IS HISTORICALLY  
 LOW, THIRD QUARTER EXPENDITURES SHOULD REMAIN IN LINE.  
 THERE ARE THREE SOURCES OF DATA BY WHICH TO MONITOR  
 COMPLIANCE WITH THE CASH EXPENDITURE GUIDELINE. WHILE  
 IS WAS INDICATED IN REF A THAT THE FINAL MEASURE WOULD  
 BE AGAINST DATA PUBLISHED IN THE SUMMARY TREASURY ACCOUNT,  
 IT NOW APPEARS THAT DATA PUBLISHED IN THE TREASURY QUARTERLY  
 CASH BUDGET FORECASTS TO PARLIAMENT WILL BE THE MEASURE  
 USED, AND THESE DATA CONTAIN SOME ADJUSTMENTS NOT MADE IN

THE SUMMARY TREASURY ACCOUNT. THIS ADJUSTMENT APPEARS MAINLY TO INVOLVE NETTING OUT OF HOSPITAL DEBT CONSOLIDATION, BUT THIS DOES NOT ACCOUNT FOR THE ENTIRE DIFFERENCE. THE TWO ARE NEVERTHELESS SUFFICIENTLY CLOSE TO PERMIT USAGE OF THE SUMMARY TREASURY ACCOUNT DATA AS A PROXY TO FOLLOW MONTHLY EXPENDITURE LEVELS. THE APPROPRIATE TABLE HAS BEEN RECONSTRUCTED BELOW TO INCORPORATE ALL THREE DATA SETS.

TABLE 4  
CENTRAL GOVERNMENT CASH EXPENDITURES  
(BILLIONS OF LIRE)

	IMF/EC		GOI#	
	I	II	III	CY77
IMF/EC GUIDELINE				55,350
EMB. ESTIMATES	14,340	12,010	13,000	55,350
CUMUL.	26,350	39,350	55,350	
TREASURY QTLY				
FORECAST	14,876	10,949		56,050
CUMUL.	26,175			
TREAS. SUM. ACC.	15,226	12,362	5,425	
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	(1 MO)	
CUMUL.	27,588	33,013
	(7 MOS)	
BOI	14,856	12,385
CUMUL.	27,241	

# TREASURY REVISED CASH EXPENDITURE FORECAST AS PRESENTED TO PARLIAMENT JULY 26, 1977.

6. COST OF LIVING ESCALATOR INDEX. NEW DATA ON THE ESCALATOR INDEX BEYOND THE FIRST TWO QUARTERS WILL NOT BE PUBLISHED UNTIL AFTER NOVEMBER 1. IT WILL BE RECALLED THAT THE INDEX WAS BELOW THE TARGET BY TWO POINTS DURING THESE TWO QUARTERS. THE JULY AND AUGUST OFFICIAL COST OF LIVING STATISTICS SHOW A 0.8 AND 0.7 PERCENT INCREASE, RESPECTIVELY, COMPARED TO THE PREVIOUS MONTH. WHILE PRICES MAY CLIMB SOMEWHAT IN THE MONTHS FOLLOWING THE SUMMER LULL, THERE DOES NOT APPEAR TO BE A SERIOUS THREAT TO MEETING THE TARGET FOR THE THIRD QUARTER.

TABLE 5  
COST OF LIVING ESCALATOR INDEX  
(AUGUST-OCTOBER 1974 EQUALS 100)

	TARGET	ACTUAL
FEB-APR 77	150	149
MAY-JULY 77	156	154
JULY-OCT 77	161	

7. CURRENT ACCOUNT OF BALANCE OF PAYMENTS. THERE IS STILL NO DATA BEYOND THE FIRST QUARTER FOR THE CURRENT ACCOUNT ON AN "ECONOMIC" BASIS. NEVERTHELESS, TRADE DATA ON A CUSTOMS BASIS THROUGH JULY, WHICH SHOW HIGHER THAN EXPECTED EXPORTS, AND INDICATORS OF THE LEVEL OF TOURISM SUGGEST CONTINUED IMPROVEMENT OF THE CURRENT ACCOUNT THROUGH THE SECOND QUARTER. DATA THROUGH MID-AUGUST ON THE OVERALL BALANCE OF PAYMENTS ALSO POINTS TOWARD A BETTER THAN EXPECTED IMPROVEMENT IN THE CURRENT ACCOUNT. LIMITED OFFICIAL USE

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THEREFORE, CHANCES HAVE IMPROVED THAT THE CURRENT ACCOUNT FOR THE CALENDAR YEAR 1977 MAY CLOSE IN BALANCE, AS COMPARED WITH THE 500 BILLION LIRE (\$566 MILLION) DEFICIT INITIALLY FORECAST BY GOI. THIS WOULD PUT ITALY IN A MUCH BETTER POSITION OF MEETING THE IMF GUIDELINE OF A 500 BILLION LIRE SURPLUS BY MARCH 31, 1978.

8. COMMENT. THE STABILIZATION PROGRAM IS PRODUCING THE RESULTS DESIRED AND THERE SEEMS TO BE GROWING CONFIDENCE (AMONG OFFICIAL TECHNICAL STAFF AT LEAST) THAT THE TARGETS FOR 1977 WILL BE MET WITHOUT SIGNIFICANT DIFFICULTY. CONCERN IS DEVELOPING, HOWEVER, THAT THE OVERALL EFFECT OF THE STABILIZATION PROGRAM HAS BEEN MORE DEFLATIONARY THAN ANTICIPATED AND THAT SUPSUIT OF TARGETS AGREED IN THE LETTER OF INTENT FOR 1978 WILL CONTINUE THAT TREND. THOSE CONCERNED FOCUS PRIMARILY ON DOMESTIC CREDIT EXPANSION CEILING, WHICH IS CURTAILING INVESTMENT, THE LOW DOMESTIC DEMAND WHICH HAS SPED THE FALL IN INDUSTRIAL PRODUCTION AND UNREALISTIC EXPECTATIONS FOR CURBING THE OVERALL PUBLIC SECTOR DEFICIT. THE GOVERNMENT WILL BE HARD PUT TO DESIGN A PROGRAM FOR 1978 WHICH WILL AT ONCE ALLAY THE FEARS OF THE GROWING BODY OF CRITICS OF THE ECONOMIC MEASURES AND BE ACCEPTABLE AS MEETING THE SPIRIT OF ITS OVERALL COMMITMENTS WITH THE IMF AND EC AND THUS MAINTAIN THE NEWLY-REGAINED FOREIGN CONFIDENCE. GARDNER

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**To:** STATE TRSY MULTIPLE  
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